# Real Estate Investment Trusts (REITs) – Franchise Tax Computation

## Public Chapter 1019 (2006)

**Franchise and Excise taxes notice #06-08**

Effective July 1, 2006, Public Chapter 1019 amends Tenn. Code Ann. Sections 67-4-2105 and 67-4-2108 concerning the franchise tax computation for persons treated as partnerships for federal tax purposes that are owned, directly or indirectly, by a real estate investment trust (REIT). For the period beginning July 1, 2006, such entities are required to compute and pay franchise tax in the same manner as all other taxable entities in Tennessee.

Under prior law, partnerships that were wholly-owned whether directly or indirectly by a REIT were exempt from franchise tax. Partnerships that were less than wholly-owned but more than 50% owned by a REIT were exempt from franchise tax to the extent of the entity's direct or indirect REIT ownership. To the extent that a majority REIT-owned partnership was taxable, it was only required to compute its franchise tax liability using apportioned net worth and was not required to report the book value of real and tangible property on Schedule G.

This Public Chapter removes the exemption from the franchise tax for all persons or taxpayers directly or indirectly owned by a REIT beginning July 1, 2006.

A taxpayer that previously qualified for this exemption should compute its franchise tax base for any portion of its tax year through June 30, 2006 *including the exemption*. It should then compute its franchise tax base for any portion of their tax year from July 1, 2006 and ending on the last day of its tax year *without the exemption*. The two franchise tax bases should then be averaged to determine the correct base to report on Schedules F (Net Worth) and Schedule G (Determination of Book Value of Real and Tangible Property).

Example: Taxpayer files a 2006 calendar year return. Its net worth base under the exempted period is $100,000. No Schedule G base was required. Its net worth base for the non-exempted period is $1,000,000. Its Schedule G base is $2,000,000. The net worth average for the year is $550,000. The Schedule G average is $1,000,000. The franchise tax for the year would be based on the greater of these two amounts. In this example, the franchise tax base would be $1,000,000, and the franchise tax due would be $2,500 based on Schedule G.

Taxpayers must include a schedule reflecting the calculations used to arrive at the franchise tax base on the 2006 transitional return.

Taxpayers should increase their estimated franchise, excise tax payments due after July 1, 2006 in relation to the expected increase in tax.

If you have any questions about this notice, you may contact the department. Tennessee residents outside the Nashville calling area may call our statewide toll-free number at (800) 397-8395. Callers from Nashville or out-of-state may dial (615) 253-0700. You can access additional information on our Web site at www.Tennessee.gov/revenue.

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